



Final Report to Governor Brian Schweitzer

Transformation and Accomplishments of the Department of Revenue

January 2005 to January 2013

Dan Bucks, Director of Revenue

January 7, 2013

Preface and Background

Acknowledgement

This report summarizes the accomplishments of the Montana Department of Revenue from January 2005 to January 2013 under the leadership of Governor Brian Schweitzer. As his appointed Director of Revenue, I thank Governor Schweitzer for his continuous support of the Department and its work. Without his support and leadership, the extraordinary progress made by the Montana Department of Revenue would not have been possible.

The Purpose of the Department of Revenue

Woven into the Montana Constitution are two moral imperatives that are the foundation of modern democratic society: 1) a guarantee of individual human rights and 2) a commitment to equitable taxation. Without a guarantee of human rights, individuals cannot participate meaningfully and effectively in society. Without equitable taxation, citizens—acting as the body politic—cannot pursue their common goals through governmental action.

This second imperative—equitable taxation—substantially defines the role of the Department of Revenue in the life of this state. It is the Department's duty to ensure as much as possible within available resources that the tax laws of the state apply fairly and equitably to all taxpayers—with non-compliance kept to a minimum. If the Department is successful, citizens and businesses will pay only the taxes properly assigned to them and not, in addition, taxes that belong to others. Further, if tax laws are equitably applied, the revenue intended to be paid under the law will more fully collected—thus contributing to the fiscal stability of the state and a broadening of the policy choices available to the Legislature and Governor. Finally, maintaining the equity and integrity of the tax laws strengthens public confidence in and trust for their government.

The Department of Revenue fulfills this role in two broad ways: 1) ensuring proper compliance by citizens and businesses with state taxes, and 2) equalizing the valuation of property under the law. The Department determines the classification of property and assesses its value directly, and the quality of this work largely determines the degree of equity in property taxes. In contrast, state taxes are generally self-assessed by taxpayers, with the Department checking compliance and correcting instances of non-filing or underreporting after the fact. For state taxes, the initial quality of taxpayer filing combined with the effectiveness of the Department's compliance activities determines the degree of equity achieved for state taxes.

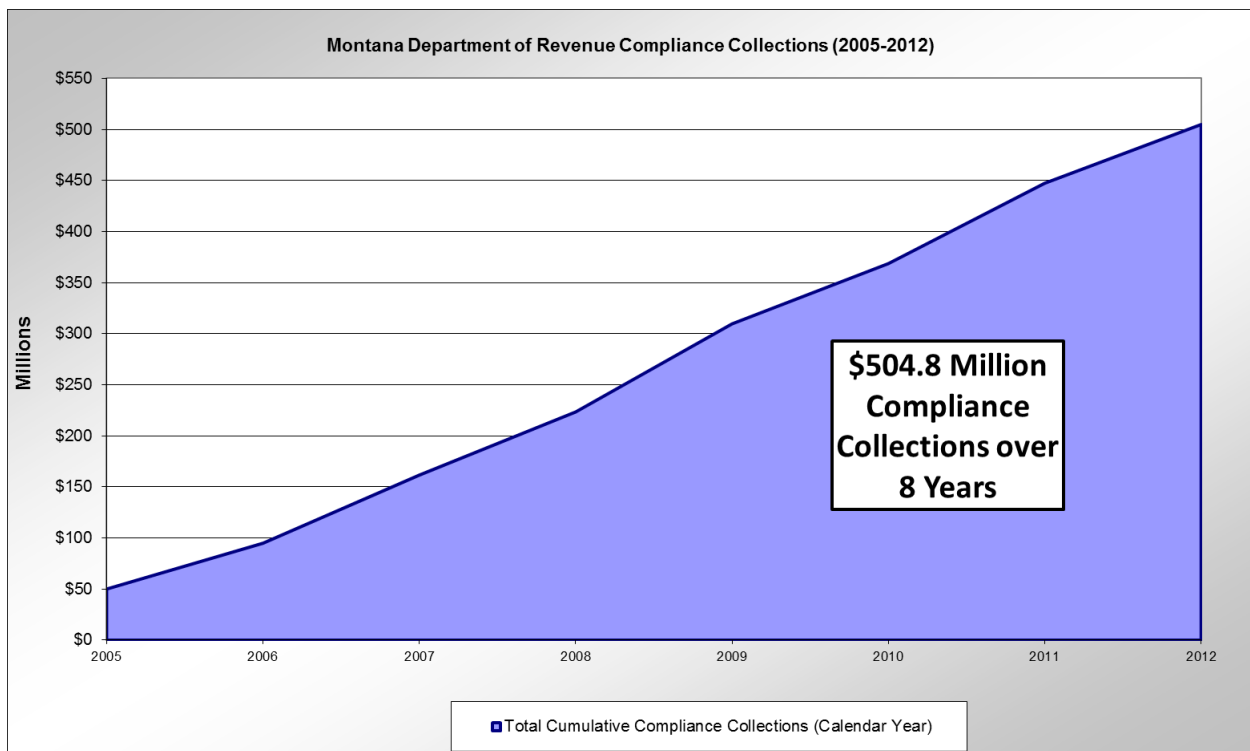
Transformation

The Department of Revenue transformed itself in this period from an agency under substantial stress—stress caused by misguided direction and management in prior administrations—to a high quality, high performing organization properly focused on fairness and equity in taxation, and public health and safety and efficiency in liquor law administration. It is vital to understand that challenges confronting the Department were not created by the Department staff—talented people who over several decades have worked hard to serve the public efficiently, effectively and with integrity. Instead the stress and challenges arose from unfortunate policy decisions to divert the Department’s focus from fairness and equity in taxation to becoming a “back office” processor for state government financial transactions. That change of focus led to efforts to create an organization, management processes and computer systems foreign to any revenue agency in the country. Those efforts ultimately and predictably collapsed by the early years of this century. Efforts to recover the Department’s traditional role began in 2002 and 2003, but accelerated after 2005. Under the Schweitzer Administration, the Department has fully transformed itself into an organization effectively achieving its proper goals under the law. That transformation has been largely propelled by the talent, energy, collaboration and goodwill of the Department staff willing to work hard to achieve beneficial change within the context of maintaining the integrity of the law and the respect for the dignity of the citizens of Montana.

Accomplishments—2005 to 2013

Tax Fairness through Record Compliance Collections

Governor Schweitzer asked that the Department of Revenue raise revenue without raising taxes by ensuring equity in taxation. The department has succeeded in achieving this goal to a spectacular degree. It has doubled the ratio of compliance collections to compliance expenditures from 3.6 to 1 FY 2002 to 7.4 to 1 over the last eight years—achieving over a half a billion in compliance collections over the last eight years—a total of \$504.8 million to be more precise. This amount is greater than the current general fund balance of the State of Montana.



Tax research experts have determined that direct tax enforcement produces a “deterrent effect” that results in increased voluntary tax payments. They estimate that the deterrent effect produces collections several times as large as the direct enforcement activity—the estimates range up to 16 times the direct compliance collections. Using a conservative \$2 in increased voluntary collections for each \$1 of direct compliance collections, the department has likely produced a total of \$1.5 billion in new revenues over eight years through the combination of direct and voluntary tax compliance. A large portion of these revenues has come from non-residents and out-of-state corporations.

These new revenues have helped finance a wide range of Governor Schweitzer’s policy initiatives including, but not limited to:

- The largest single tax cut in the history of the state—the 2007 \$400 residential property tax refund.
- Reductions in the business equipment tax.
- Tuition freezes at Montana public colleges and universities.
- Record increases in state funding to K through 12 public schools.
- Funding for full-time kindergarten and “Indian Education for All.”

Tax Fairness through Equalization of Property Taxes

The 1972 Constitutional Convention made equalization of property taxes its top priority for the Revenue and Finance Article of the new Montana Constitution. They established a statewide valuation system administered by the Department of Revenue to replace local assessment, which the convention found fraught with favoritism, inequities and political agendas of elected assessors to the point that Delegate Mick McKeon labeled the local assessment as “the greatest evil” in state and local government. The Department in this administration has fulfilled the mandate of the state law to secure a “fair, just and equitable valuation of all taxable property” in the following ways:

- The 2009 residential and commercial property reappraisal—conducted in the midst of tumultuous market conditions—was remarkably accurate with residential property appraised within 0.3% of current sales prices and commercial property appraised within 9.2% of sales prices. International property appraisal standards consider any appraisal within 10% (high or low) of sales prices to be accurate for tax purposes. Further, the uniformity of appraisals met or exceeded statistical standards for property tax appraisals.
- The Department has protected homeowners and small businesses from tens of millions of dollars of property tax increases annually by successfully defending against unjustified claims by large corporations seeking huge property tax reductions. Instead, the Montana Supreme Court in two landmark cases—*PPL Montana* and *PacifiCorp*—has determined that the Department’s method of valuing corporate centrally assessed property to be proper and equitable in achieving market value for these properties.
- The Department implemented in 2009 an objective system of agricultural land valuation based on soil science—replacing antiquated valuations dating back to 1963 that were a product of the local assessment era beset with favoritism and inequities.
- In terms of equal treatment of property taxpayers, the Department applies to all property taxpayers—large and small—the same procedures and standards of accountability. The Department frequently encounters requests from large corporate taxpayers for negotiation of valuation settlements without producing facts and justifications relevant to the determination of value. However, Montana law and practices do not allow residential, commercial and other taxpayers access to negotiated settlements without producing relevant information and justifications relevant to the valuation of property. Hence, the Department applies the same standards to large corporate taxpayers and does not enter negotiations with large

corporations without full and fair facts being disclosed by these companies. The result is a responsible approach to settlements that protects ordinary taxpayers from unfair tax shifts that would result if the Department negotiated corporate tax settlements blindly without adequate facts. Thus, no taxpayer is disadvantaged because other taxpayers were provided special, preferential treatment. This commitment to equal treatment of all taxpayers in disputed cases is a key means by which the department meets its statutory mandate to do “all things necessary” to achieve a just and equitable valuation of property in the state as required by 15-9-101(1) MCA.

The result of the work described above and other efforts of the Department is that property tax values may currently be the most equitable in the history of Montana.

Property Equalization and Constitutional Requirements for School Funding

Montana’s strong constitutional commitment to property value equalization through a statewide assessment system was established, in part, to support the constitutional provisions on adequacy and equalization of school finance. During this administration, a challenge to the system of school equalization arose in the form of action by Fallon County to establish an industrial tax increment financing district covering a third of that county along oil pipeline corridors. The effect of the district would have been to substantially divert future statewide property revenues for school equalization from the state treasury to the county government. The department successfully reversed this effort and protected school equalization—and was sustained in its decisions by the Montana Supreme Court. In the course of this process, the department established rules and procedures to ensure consistent boundaries and guidelines for local governments to follow in establishing tax increment districts consistent with the law.

Responsive Service Respecting the Rights and Dignity of Each Person

Although Department contacts with citizens are at an all time high, so are the ratings that Montanans give to the Department staff on their courtesy, respect and professionalism. Surveys of persons audited by the Department or their tax representatives indicate that 85% of Montanans view the staff’s work positively. Negative ratings are in the single digits, with the remainder of survey answers being neutral or not responding. The Department’s effective recruitment and training of staff has produced a workforce that applies the law while effectively respecting the dignity of citizens.

While the Legislature enacted a law in the early 1990s requiring the appointment of a Director of Taxpayer Assistance to resolve the most serious taxpayer complaints lodged with the Department, this Administration is the first to actually implement this law. The Department’s Director of Taxpayer Assistance has successfully resolved over 130 cases in the past year.

The Department’s call center—reachable in this administration by a toll-free number—answers 120,000 calls a year with 75% handled without a referral to other staff.

The Director's Office executive staff is highly trained and effective in managing every type of communication that comes into this office. These staff members receive high marks and praise from across state government for their high level of talent and competence in resolving issues and getting work done well.

Montana has one of the most complex income tax laws in the nation. This administration has rewritten forms, instructions, letters and rules to meet "plain language" standards and has ensured that all provisions of the law are fully disclosed to taxpayers. The Department continually improves the forms and instructions each year.

This administration has implemented the first online tax filing services in the history of the state. It has also provided vital computer support to non-profit organizations assisting low-income persons and the elderly with the filing of tax returns.

Complaints from citizens to the Director's Office concerning Department staff—frequent at the beginning of the administration—have dwindled to only a few each year. The complaints have been replaced by compliments to the staff—with several arriving each month.

Department staff members deliver service to citizens with a human touch. Here are examples:

- Kid-sized tables, toys and coloring books are placed in taxpayer assistance rooms so that parents can more easily bring their children with them when seeking help from the Department.
- A staff member delivered taxpayer assistance to an elderly, disabled citizen in the back of his car when it became clear that the person could not easily walk to the Department's building.
- Other staff members have sorted through tens of thousands of tax returns to expedite refunds and protect citizens from hardships. In one case, the Department prevented an eviction of a mentally challenged person from her home. In another case, the Department enabled a father to get his car out of a repair shop so that he could get his children to school.
- Department leaders have found ways to provide relief to persons facing severe hardships and unfair state tax liabilities due to the illegal activities of abusive spouses—even though those persons cannot qualify for federal innocent spouse relief due to unrealistically high dollar thresholds imposed by the IRS on such relief. By carefully determining that these innocent persons are victims who otherwise meet all other criteria for innocent spouse relief, the department is providing vital help to citizens who are destitute and living in desperate circumstances due to no fault of their own.
- Property tax staff in Musselshell County and surrounding expedited disaster property tax relief to citizens who lost property to two major floods in 2011 and devastating fires in 2012. To help citizens through these tough times, the staff proactively sent disaster relief forms out to disaster victims—instead of waiting for the citizens to request the assistance. They worked with the Red Cross to identify those in need of help. With the help of property tax staff from nearby counties, they

expedited the field reviews so that those who suffered losses had rapid assurances that they would receive property tax reductions for which they qualified.

The Liquor Control Division in cooperation with its trucking contractor has helped deliver the First Lady's school gardening project equipment and supplies to local schools as well as various types of Office of Community Service materials to remote locations in Montana.

The Liquor Control Division implemented a new mandatory server training program after the 2011 legislative session quickly and smoothly—and today server training is available across the state increasing public health and safety.

The Department through its tobacco marketing authority prevented cigarettes disguised as fruit flavored "little cigars" from being marketed to underage persons. Public health experts applauded this action for helping to reduce cigarette addiction among Montana teenagers.

Advancing State-Tribal Cooperation

At the Governor's initiative, the Department of Revenue entered new tribal revenue sharing agreements or updated and expanded tribal agreements with Montana tribal governments with direct taxing authority. Through nine alcohol or tobacco tax agreements, the Department has shared \$33.8 million dollars of revenue with six tribal governments over the last eight years. Two other agreements—one completed and the other being finalized—for oil and gas production taxes are expected to produce revenues in the future.

With the historic leadership of Governor Schweitzer on state-tribal relations, the Department of Revenue, the Indian legislative caucus and individual tribal governments were able to convince the 2011 legislative session to enact historic legislation establishing state property tax exemptions for tribal property. SB 412, sponsored by Sen. Shannon Augare, provides for a temporary exemption up to five years for tribal fee land for which a tribe is seeking trust status. HB 618, sponsored by Rep. Carolyn Pease-Lopez, provides tribal governments with equal access to the governmental, educational and charitable property tax exemptions that are provided to local governments and non-profit organizations.

While all state-tribal revenue sharing agreements are important in terms of fiscal cooperation, agreements involving oil and gas production taxes also have the benefit of providing greater tax certainty to the oil and gas industry with regard to reservation oil and gas development. With your leadership, the Department was able to develop and implement such an agreement with the Fort Peck Assiniboine & Sioux Tribes. The Department also developed an oil and gas production tax agreement with the Blackfeet Tribe—an agreement that Governor Schweitzer and Attorney General Bullock have authorized—but which awaits implementation contingent on certain tribal actions required by state law and the terms of the agreement.

Ensuring the Integrity and Efficiency of Department Operations

At the outset of this administration, the Department was still recovering from a disastrous computer system failure costing Montana at least \$63 million (the full loss has never been tallied). Tens of thousands of taxpayer accounts were lost or in error. The department completed the majority of the work installing a new, accurate and high quality tax system after 2005. More impressively, this system has been completely updated twice since—without any significant lapse of service or significant operating difficulties. This administration also installed a new property tax system in the course of the 2009 reappraisal cycle, followed by a state-of-the art document imaging system that gathers several times the tax data from each return. While no computer project is without challenges, this administration implemented new systems with a high level of computer quality and competence.

The Department was one of the leaders among state agencies in reducing energy consumption in response to the Governor's 20 by 10 energy reduction challenge. A major renovation of the 40-year-old liquor warehouse produced major improvements in both energy and operational efficiency.

The Department has implemented a performance management system that is a model for state government. Guided by core values of respect, integrity and justice, productivity and teamwork, the system extends to quantifiable objectives, performance measures and staff appraisal standards. The Department knows what it is doing, why and by what means throughout the agency and in terms that enable it to measure effectiveness and efficiency and to continually improve its operations.

The Department consolidated its technology and tax processing operations—previously spread among four facilities—into one location in downtown Helena. Local Helena leaders praised the Department for moving its operations to a central location. The downtown facility enables a higher level of efficiency in processing returns and payments—earning extra interest for the state general fund every business day.

The Department has reduced liquor warehouse operating costs as a percentage of liquor sales, thus increasing profits to the state general fund. Besides the operational efficiencies from the warehouse renovation, the staff has implemented new technology for inventory management and liquor distribution and numerous improvements to business practices.

The Liquor Control Division has also streamlined its liquor licensing process through changes in business practices and new technology, including online liquor license applications.

The Department delivered \$400 property tax refunds to 250,000 households in 2007 within a total elapsed time of 5 months—from the design of a new computer system to the delivery of the checks. The Department earned compliments for its efficiency and effectiveness from legislative critics of the program.

Supporting a Collaborative Workplace

The contemporary tax agencies are complex organizations comprised of interrelated parts that must work together if the agency is to be as productive and successful as possible. A healthy and productive Department of Revenue requires detailed collaboration across organizational units. For that reasons, the department has made special efforts to foster strong, working relationships within the agency.

- The Department of Revenue receives high marks from its union for respectful and effective cooperation—resulting in effective working relationships between management and workers. This relationship has been strengthened in the past year through the reactivation of a Labor-Management Committee for mutual problem solving. In only a few months, the committee has produced tangible results in addressing important workplace issues.
- The department has a diverse workforce with participation by women and minority persons that consistently meets equal employment opportunity standards. The result is a workforce that mirrors and understands Montana and that adds a broad range of ideas and perspectives to our work.
- Guided by the core values of respect and teamwork, the department uses a variety of teams to produce higher quality results through collaborative work by experts in various fields. As a result the department has produced:
 - forms, instructions, letters and rules that are easier for citizens to understand and use
 - better computer systems that produce greater performance and results
 - increased compliance collections, and
 - higher quality of service to taxpayers.

Conclusion

All of the above accomplishments and more provide solid evidence that the Montana Department of Revenue has effectively transformed itself into a highly efficient and effective organization that does the right work in the right way for Montana citizens. While Montana is a small state in population, its tax agency has attracted respect for the quality and excellence of its work from other tax agencies around the nation. The Department appreciates the support of Governor Schweitzer in providing the leadership that helped make this transformation possible.